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International Economic & Energy Weekly

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International Economic & Energy Weekly

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Political trouble caused by reaction to economic austerity measures is spreading. Strikes and violence have flared up over the past month in countries as disparate as Suriname, Sierra Leone, Tunisia, and Israel. 25X1

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This article in our series on economic and political aspects of the international financial situation examines changes in real exchange rates. For a select group of 15 LDC debtors, our analysis shows that most of these countries experienced real devaluations last year. 25X1

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29 **Airbus Industrie: Prospects for the A320 Enhance Long-Term Goals**

Western Europe's Airbus Industrie appears near a formal commitment to build the A320, an all-new, 150-seat, advanced technology aircraft. An Airbus Industrie move into the narrow-body sector of the commercial aircraft market will erode US sales, set the stage for further expansion of the consortium's product line, and make profitability of any all-new US program harder to attain. 25X1

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Perspective

Longer Term Aspects of the LDC Debt Crisis [redacted] 25X1

The international financial community is currently involved in another round of LDC debt relief negotiations, which include rescheduling this year's maturities, raising new credits, and setting 1984 IMF economic performance targets. Despite debtor demands for easier terms on new and restructured loans and some smaller bank resistance to new loan participation, most Western financial and government observers are optimistic that financial packages will be completed and disruptions to the banking system will again be averted. The prospect of continued OECD economic recovery, improved LDC exports, and lower or at least stable interest rates is contributing to Western confidence that the LDCs' ability to service their debt is improving. [redacted] 25X1

Although short-term LDC debtor cash flow problems may be under control, longer term and more difficult aspects of the debt crisis remain. These include the need for structural economic and institutional change in the LDCs, sustained world economic recovery and expanded trade, and the assurance of sufficient future capital flows to the Third World. Concentration on the current financial aspects of the LDC debt crisis risks papering over these more fundamental problems. [redacted] 25X1

In many debtor countries, subsidies and controls on prices, interest rates, and exchange rates have stimulated demand without improving productive capacity. At the same time, these price distortions have encouraged capital outflows. Development policies have sustained large inefficient public-sector enterprises and bureaucracies, which have consumed large amounts of foreign capital but which, in many cases, earn small amounts of foreign exchange. Only a fundamental restructuring of domestic markets can correct these distortions and accomplish a major shift of resources to export-oriented industries. Such a restructuring, however, will involve very difficult social and political decisions. [redacted] 25X1

Medium-sized enterprises in the private sector could play an important role in this restructuring process. Unfortunately, private-sector initiative in most debt-troubled LDCs has been weakened by recent government austerity measures, which have placed much of the adjustment costs on the private sector. In addition, current debt-rescheduling practices focus on public debt and have left private-sector debt repayment problems largely unresolved. As a result, incentives for providing new foreign risk capital to LDC private enterprises have been seriously eroded. [redacted] 25X1

It is unclear whether LDC governments are prepared to carry out needed economic adjustments and pursue new development strategies. Debtors generally have been successful in meeting external economic targets—largely through import reductions. Domestic objectives, however, including reductions in inflation and fiscal deficits, in most cases were not achieved last year. Moreover, the Plan of Action issued this month by Latin American heads of government at the Quito economic conference proposes to respond to the debt crisis by reducing interest payments and spreads, lengthening grace periods and maturities, assuring new commercial and financial credits, increasing IMF resources, and revising IMF conditionality criteria. Notably absent were suggestions for changes in domestic economic policies and encouragement of the private sector. [redacted] 25X1

Longer term resolution of the debt problem also depends on open trade policies in the creditor countries. This will require some restructuring of economic activity on the part of the industrialized countries. For this to occur, government assistance to old, inefficient industries will have to be curbed and newer activities with a competitive advantage encouraged. Furthermore, industrialized countries will have to allow LDCs to export a greater share of manufactured goods at competitive prices. [redacted] 25X1

Although improved LDC internal policies and expanded trade opportunities will help rebuild banker willingness to lend voluntarily to debt-troubled LDCs, new sources of capital flows probably will have to be stimulated. Because of tighter bank supervision and concern over future profits, major international banks may be constrained from playing so dominant a role in financing LDC payments deficits in the years immediately ahead. Official credits and private direct and equity investment could fill the gap, although the latter would entail changes in restrictive and, in some cases, hostile attitudes of LDC governments. Nonetheless, alternatives to commercial bank capital flows would have to be explored and encouraged now to ensure capital flows later in the decade. [redacted] 25X1

If domestic opposition to current austerity measures grows, LDC officials may find it convenient to denounce the current debt strategy as ineffective in addressing longer term economic problems. This tactic would risk undercutting existing efforts to avoid financial disruptions. At a recent Washington economic conference, former Brazilian Central Bank President Langoni labeled current IMF stabilization programs as too contractionary, suggested the need for a new negotiating framework, and called on the banks to recognize their mistakes and accept the necessary losses. [redacted] 25X1

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Briefs

Energy

OPEC's Price Discounts

Several OPEC countries are experiencing difficulty selling crude and reportedly will resort to aggressive marketing tactics including price concessions to maintain export levels. [redacted] 25X1 25X1 A reduction in export contract volumes for 1984 has forced Iraq to resort to spot market sales at prices about 50 cents below official levels to dispose of its crude. Iran has renewed contracts for up to 1 million b/d this year by pegging contract prices to spot prices. 25X1 Indonesia reportedly has entered indirect discounting arrangements with oil-trading companies, which are reselling Indonesian crude purchased at official prices on the spot market. To compensate for the loss on spot sales, Pertamina—Indonesia's state oil company—reportedly provides these traders with petroleum products at prices significantly below market levels. [redacted] 25X1 25X1 25X1 Widespread price discounting by OPEC members will put additional downward pressure on prices and weaken the cartel's already fragile price structure. [redacted] 25X1

Spot Oil Market Trends

Spot crude oil prices have rebounded to near official levels for many crudes following a cold snap that increased consumption and tightened inventories. Spot prices for Arab Light now approximate $28.65 per barrel compared to its official price of $29 and a mid-December spot price of $28.20. UK Brent and Nigerian Bonny Light have also strengthened and are selling at about $29.50 per barrel—50 cents below their official prices. Although US oil demand 25X1 continues to rise, much of the recent resurgence in consumption probably can be attributed to seasonal factors. Prices could weaken in coming months in the absence of a sustained strong rebound in demand. [redacted] 25X1

West European Gas Market Trends

West European gas consumption rose 3.5 percent above year-earlier levels in the first nine months of 1983, reversing the downward trend in demand begun in 1980. Gas demand in the United Kingdom—currently Western Europe's largest gas consumer—rose 5 percent, while France, the Netherlands, and Belgium experienced increases of 6, 6, and 9 percent, respectively. Rising gas use in Dutch and Belgian electric power stations accounted for nearly one-half of the increased West European demand. On the supply side, indigenous 25X1 production was up 4 percent, with shipments from the Netherlands—Western Europe's largest gas supplier—up nearly 5 percent. West European imports of Algerian gas more than doubled as deliveries of liquefied natural gas (LNG) to

EC: Gas Supply and Demand

	Thousand b/doe		Percent Change
	Jan-Sep 1982	Jan-Sep 1983	
Demand	3,185	3,298	3.5
United Kingdom	807	847	5.0
West Germany	781	784	0.4
Netherlands	550	584	6.2
France	417	444	6.5
Italy	450	443	−1.6
Belgium	137	150	9.5
Other [a]	43	46	7.0
Supply	3,293	3,455	4.9
Indigenous production	2,358	2,456	4.2
Imports	935	999	6.8
Norway	460	406	−11.7
USSR	372	358	−3.8
Algeria	102	234	129.4
Other	1	1	
Stock increase	74	130	
Losses	34	27	

[a] Ireland, Greece, Luxembourg, and Denmark.

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France and Belgium increased sharply under existing contracts and Algerian gas supplies began flowing to Italy through the recently completed Trans-Mediterranean pipeline. Increased Algerian deliveries and higher Dutch sales came at the expense of Norwegian and Soviet gas imports, which declined by 12 and 4 percent, respectively.

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Nigeria Names New Minister of Petroleum and Energy

Professor Tamundemi Sokari David-West has been appointed Minister of Petroleum and Energy by Nigeria's new military government. A civilian educated in the United States, David-West has no previous government experience or background in oil matters; his appointment comes as a surprise to many in the oil industry. He replaces Yahaya Dikko who served as energy adviser and representative to OPEC during the Shagari administration. We believe that General Buhari will continue to make all final decisions regarding energy matters and probably will rely heavily on Festus Marinho, whom he recently reappointed as Managing Director of Nigeria's National Petroleum Corporation, for advice on oil policy. [redacted] 25X1 25X1

Financial Threat to Angolan Oil Development

[redacted] financial problems are hampering the government's efforts to secure almost $200 million in Western credits to finance construction of offshore oil production platforms in the Takula fields. 25X1 [redacted] 25X1 [redacted] To carry out its oil development plans, the government probably will be forced to establish the long-term accounts with European banks. [redacted] 25X1 25X1 25X1

Fourth Emirate Begins Production in UAE

Ra's al-Khaymah began producing 5,000 b/d of condensate from its offshore Saleh field this month, joining Abu Dhabi, Dubayy, and Sharjah as commercial producers in the United Arab Emirates (UAE). The field, operated by Gulf Oil, is expected to reach peak output of about 30,000 b/d by midyear. Because condensate is considered a natural gas liquid (NGL), production by Ra's al-Khaymah will not be counted against the UAE crude oil output quota of 1.1 million b/d imposed by OPEC. Other emirates are also pushing to increase condensate production. In Dubayy, the new Margham condensate field is scheduled to start at 20,000 b/d this year, increasing to 80,000 b/d by 1985. Sharjah's production from the onshore Sajaa condensate field operated by Amoco has risen to 40,000 b/d and is scheduled to increase further to 55,000 b/d later this year. As a result, total production of condensate and other natural gas liquids in the UAE will approach 200,000 b/d by the end of 1984, adding to world oil supplies and further dampening prospects for increased exports from financially strapped producers such as Nigeria. [redacted] 25X1 25X1

Brunei Seeks Control of Energy Resources

Brunei, the small, oil-rich Southeast Asian sultanate that gained independence on 1 January, is moving to increase its control over its petroleum resources. The sultan recently appointed a permanent secretary for petroleum affairs, plans to increase the use of independent consultants for advice on energy exploration and development, and is considering joining OPEC. The government intends to assume majority ownership of the country's only oil-producing company, Brunei Shell Petroleum (BSP), currently a 50-50 partnership

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between Brunei and Royal Dutch Shell. [redacted] 25X1

[redacted] Brunei is currently producing 150,000 b/d of crude oil and 7 billion cubic meters annually of natural gas. [redacted] 25X1

International Finance

Argentine Economy Minister at Odds With Bankers

[redacted]

Economy Minister Grinspun met stiff resistance from US bankers over his initial plan to deal with $20 billion of foreign debt due this year. At meetings in New York earlier this month, Grinspun proposed that banks quickly disburse $1 billion remaining in a medium-term loan arranged last year. According to the US Embassy, Argentina plans to return the entire amount of the disbursement plus some of its own reserves to cover both a $350 million bridge loan payment due this month and to bring interest arrears current through the end of 1983. [redacted] 25X1 25X1

[redacted] Creditor banks, in our opinion, will press for significant progress toward a new agreement with the IMF, not expected to be completed until late April, before making new loans available or setting up a rescheduling program. Argentina must cover some $12 billion in 1982-84 public-sector maturities, $5.5 billion in interest due, and $2.5 billion in 1983 arrearages. Even with the current seasonal increase in export earnings, Argentina likely will make no more than token debt payments and will require substantial debt relief this year. [redacted] 25X1 25X1 25X1

Sudanese Problems With the IMF

[redacted]

Sudan failed to make a January payment to the IMF, and this is limiting Khartoum's financial maneuvering. As long as Sudan is in arrears to the IMF, the final $26 million tranche of its 1983 standby agreement cannot be drawn, and negotiations for the 1984 standby will remain suspended. Even if the arrears are covered, there is a chance the IMF will cancel the final disbursement; the Fund claims Sudan has failed to comply with conditions of the 1983 standby. According to an IMF official, Sudan has not made all of the proposed reforms to its foreign exchange market. Moreover, Khartoum has failed to abide by monetary growth targets and has fallen behind in meeting debt repayment obligations to Paris Club members. Sudan likely will miss payments to the IMF and Paris Club again in February because of foreign exchange shortages and thus will further jeopardize a 1984 IMF standby agreement and debt rescheduling. [redacted] 25X1 25X1

Colombian Financial Update

[redacted]

Colombia recently stemmed the rapid decline in its foreign exchange reserves. Reserves declined from $3.9 billion at the start of 1983 to $1.8 billion—four months' worth of imports—at the end of October. Bogota was able to stem reserve losses in November and December because of seasonally higher coffee earnings. Moreover, its cash position was bolstered by a $50 million credit from the Andean Reserve Fund. Bogota expects disbursement of a $210 million syndicated loan in the first quarter of 1984 to offset the usual falloff in 25X1

coffee earnings early in the year. The country will face further payments difficulties later in the year, however, because of depressed prices for key agricultural exports and slow growth throughout the Andean trading region. [redacted] 25X1

Colombian financial scandals are adding to foreign bankers' concern about the economy. The Superintendent of Banks recently pressured the president of the Banco de Colombia—the country's largest bank—to resign; [redacted] follows last May's rescue of the Banco de Bogota—Colombia's second-largest bank—and further tarnishes Bogota's image among bankers. Some foreign creditors believe a nationalization of the banking sector could occur, and this has further tightened lending. [redacted] 25X1 25X1 25X1 25X1

Sri Lanka Benefits From Higher Tea Prices

[redacted]

Recent tea export restrictions by India and the doubling of world tea prices over the past year have considerably brightened Sri Lankan export prospects and eased foreign payments problems. Tea export earnings in 1983 rose to an estimated $355 million—the highest level since 1979—and accounted for about one-third of total exports. According to the US Embassy, Colombo is depending on higher tea prices this year to ease foreign payment problems and provide government revenues. They may be disappointed. Tea market analysts expect prices will begin to drop in the next six months, and we believe Sri Lanka then will experience a worsening in its foreign payments and may have to seek IMF and donor help. [redacted] 25X1 25X1

Global and Regional Developments

[redacted] 25X6 25X1

Australia Joins Tin Producer Group

[redacted]

Australia last week joined the five-month-old Association of Tin Producing Countries (ATPC), bringing its membership to seven countries, which account for roughly four-fifths of Free World tin production. Australia's joining reinforces the ATPC's declared mission to promote tin research and development and to improve market conditions. Australia—a supporter of the International Tin Council (ITC)—became a member of the ATPC only after

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receiving assurances from other producers that the ATPC would not follow policies that would be at odds with ITC market actions. With the exception of Bolivia, all members of the new Association are also members of the ITC. Both Bolivia and Malaysia have frequently charged that the ITC has not done enough to boost tin prices; Bolivia has supported the idea that tin producers ban together to raise prices through export controls and buffer stock operations. [redacted] 25X1

Association of Tin Producing Countries, 1982

Members	Tin-in-Concentrate Production *(thousand metric tons)*	Share of Global Production *(percent)*
Malaysia	52.3	28
Indonesia	33.8	18
Bolivia	26.8	14
Thailand	26.2	14
Australia	12.3	6
Zaire	2.2	1
Nigeria	1.7	1

[redacted] 25X1

EC To Open Trade Talks With Hungary

[redacted]

The European Community and Hungary are moving forward to negotiate a formal, bilateral trade agreement. EC Foreign Ministers on 23 January asked Commission officials to complete the EC's negotiating position so that talks can begin this spring. Negotiations with Budapest probably will result in the reduction of selected EC trade barriers and the establishment of a mixed commission to promote further economic cooperation between the Community and Hungary. EC trade with Hungary rose sharply during the 1970s, but since 1980 has fallen. Community exports to Hungary last year were an estimated 25X1 $1.7 billion and imports $1.5 billion; West Germany accounts for slightly more than one-half of the trade. [redacted] 25X1

National Developments

Developed Countries

Israeli Cabinet Approves Budget Cuts

[redacted]

On Sunday the Israeli Cabinet unanimously adopted a budget that calls for substantial spending cuts, but approval came only after Prime Minister Shamir threatened to resign. Shamir wanted to demonstrate that his government is taking steps to reduce the inflation rate of nearly 200 percent, to improve the foreign payments outlook, and to present a united front during the debate in the Knesset on Wednesday on a no-confidence motion. Most 25X1

ministers agreed to trim their expenditures by about 9 percent in real terms, according to press reports. These budget cuts, however, are unlikely to be carried out. Reductions have not been implemented in the past, and ministers have become adept at using "unanticipated" price rises to justify exceeding their spending ceilings. 25X1

Meanwhile, the government, in an effort to restore calm on the labor front, reached an agreement with the Histadrut, the large trade union organization, to increase the monthly salaries of public-sector workers by 5,000 shekels—$42 at the current exchange rate. In return, Histadrut officials have agreed to work against strikes or work slowdowns by government employees protesting the erosion of real wages until the two-year framework wage agreement expires on 1 April. Several unions involved in government operations, including engineers, technicians, and lawyers, however, have not approved the agreement. In addition, there are a number of nonwage issues, such as reductions in overtime and travel allowances recently approved by the Cabinet, that could be used to justify strike action. Other work disputes will continue:

- Railway workers are striking for a 30-percent wage hike.
- The 3,500 engineers at Israel Aircraft Industries staged a 24-hour walkout on Sunday to demand changes in their pay formulas that they claim unfairly reward lower skilled workers. 25X1

West German Strike Threat Lessens

A drop in worker support for the 35-hour workweek lessens the chance of serious industrial disputes during this spring's wage negotiations. The December poll of members of the Metalworkers Union, West Germany's largest union and pace setter for the rest of organized labor, found 43 percent opposed to the cut in working time versus 32 percent in favor—roughly the reverse of an October poll. The results probably will force a strategy shift by the union, which has been mobilizing to achieve the shortened workweek and has adopted 25X1 an uncharacteristically militant tone in the face of firm employer resistance. Removing this demand from the negotiations would be welcome news to government and business, which fear strikes could threaten the nation's economic recovery. The swing of worker opinion probably results from the government's proposed early-retirement legislation and a similar offer by the metal employers association. 25X1

West German Economic Institutes See Competitiveness Declining

Four of West Germany's five leading economic institutes, in separate studies commissioned by the Economics Ministry, conclude that West Germany is falling behind in international competitiveness. They believe the problem is not only in emerging technologies such as microelectronics and electronic data processing, but also in three traditional industries—chemicals, machinebuilding, and electrical machinery. The fifth institute—DIW in Berlin—disagrees, insisting that overall West German competitiveness is "good" and that West German investment goods have gained in international competitiveness. 25X1

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All five institutes agree that the economy is not adapting rapidly enough to international economic change. Among the obstacles to adjustment, they cite wage rigidity, inadequate labor mobility, excessive subsidization of dying industries and housing, inadequate availability of venture capital, and the low-equity capital ratios of West German firms. The majority of the institutes recommend reduced government involvement in the economy through denationalization, deregulation, and elimination of subsidies. Only DIW thought the government could play a useful role in directing research and economic activity through appropriate subsidization. 25X1

Commission on Canada's Economy Concludes Preliminary Hearings

The Macdonald Royal Commission on Economic Union and Development Prospects for Canada has concluded its preliminary hearings and has begun its deliberations. The commission was established by the Liberal government last year to identify weaknesses in the economy and suggest new policies. Although preliminary recommendations are scheduled to be released in April, the bulk of the $8 million study will not be completed until 1985. US Embassy and press reports indicate that the commission will recommend government action to reduce trade protectionism, develop high-technology industries, reform the Senate to give each province equal representation, and increase cooperation 25X1
among labor, business, and government. Several commissioners also have expressed concern over the great distrust between different groups in Canada—east versus west, provinces versus Ottawa, labor versus business—and several of the policy recommendations are likely to focus on lessening these tensions. 25X1

The commission's initial findings—favoring less frequent federal economic intervention—reflect the more conservative political trend detected in polls across Canada in the wake of the recession. Ottawa already has attempted to accommodate this mood by decreasing the nationalist tenor of its economic policy in its budget last April and its legislative program in December. The Liberals' slightly more conservative economic policy brings them considerably closer to the philosophy of the Progressive Conservative Party and suggests that the commission's recommendations will influence future Canadian policy regardless of which party is in power. 25X1

Less Developed Countries

Bracing for Labor Layoffs in the Philippines

The US Embassy and some Philippine officials anticipate layoffs of 200,000 full-time workers in the next few months because of declining economic activity. Manila has appealed to the United States for emergency food-grain assistance in an effort to forestall unrest, and it is working with the Catholic Church on a joint emergency food program. The government is encouraging 25X1
private firms to advance wages to dismissed workers, and it will provide workers with social security assistance for three months. 25X1

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Manila and other urban centers will be hardest hit by the layoffs because manufacturing activities are concentrated there. Thus far, organized labor has remained quiet, but demonstrations are almost certain to occur as layoffs increase. The government's measures will help relieve some of the hardship, but, until IMF negotiations for a $650 million standby credit are concluded and normal commercial financing of import trade resumes, economic activity will remain slow and workers will continue to lose their jobs. [redacted] 25X1

Moroccan Unrest Subsides

[redacted]

An uneasy calm prevails in several Moroccan cities after as many as 100 persons have been killed in the last two weeks in demonstrations against impending hikes in food prices and student fees. In an effort to reestablish order, the King last weekend promised an end to price increases, accused foreign extremists of fomenting the unrest, and warned of stern reprisals should further disturbances occur. Army troops have been airlifted to troubled locations to quell new agitations. Labor unions, thus far, have not participated in the demonstrations, and political parties have been supportive of the regime's efforts to deal with the unrest. The success in holding off price 25X1 increases and the damage done to the regime's prestige, however, could inspire young radicals and Islamic fundamentalists to incite further disruptions despite the extraordinary security measures. [redacted] 25X1

Events of the past week will make it difficult for Rabat to follow through on economic austerity. In addition to popular unrest, concern over new austerity measures has caused a run on some banks by wealthy Moroccans, [redacted] 25X1 To boost confidence, the King may adopt a more expansionary economic program to redress growing unemployment—over 25 percent in 25X1 urban areas—as he did in 1981. Failure to limit government spending and to reduce domestic consumption, however, will jeopardize Morocco's IMF standby loan and could endanger aid flows. [redacted] 25X1

Mexican Tax Reforms

[redacted]

Mexico City hopes to boost tax revenues this year through better collection procedures. At the same time, the government has cut income taxes to increase take-home pay and has made some adjustments in corporate taxes. According to press reporting, Mexico City is banking on a concerted drive against tax evasion to provide the bulk of an anticipated 63-percent increase in 1984 tax receipts. The Mexican treasury will establish a task force of 3,000 recent law school graduates to examine cases of suspected evasion. Punishment of evaders was also stiffened; the government may now seize assets after only one notice 25X1 instead of the three required in the past. To stimulate consumer demand, income taxes were eliminated for taxpayers in the lowest tax bracket and reduced in higher brackets. The resulting drop in revenues will be partially compensated for by increased fees on state-provided services and higher taxes on vehicle ownership. Small increases in corporate tax rates are offset by liberalized depreciation allowances, new provisions for writing off losses, and other tax breaks. Increased taxes on corporate dividends are designed, in part, to discourage payouts and to prod firms to reinvest profits. [redacted] 25X1

Venezuela's New Economic Cabinet

Venezuelan President-elect Jaime Lusinchi has drawn together a diverse mix of economic advisers, and this could limit action to confront economic and financial problems. According to US Embassy reports, Manuel Azpurua—a businessman who lacks national political experience—will take over the key Finance Minister slot. Hector Hurtado will be Lusinchi's new Development Minister. He reportedly wants to introduce gradually the reforms necessary to promote economic recovery and restructure the external debt. In contrast, Luis Matos Azocar, the new Minister of Coordination and Planning, is a strong proponent of state intervention and deficit spending. Diaz Bruzal, the only holdover from the Herrera administration, will remain as Central Bank president. He has proposed tough economic reform measures such as the immediate devaluation of the bolivar and balancing the federal budget. 25X1 25X1

We believe Lusinchi will find it difficult to balance the competing policy recommendations made by his economic advisers. Lusinchi lacks a good understanding of Venezuela's economic problems, and we believe he is likely to vacillate between the diverse views held by his advisers. This could prevent a quick reconciliation with the IMF. Recommendations by the Fund to balance the budget, devalue, and remove subsidies likely will prove unacceptable to most members of the economic team. In turn, resistance to an IMF program will impede Venezuela's negotiations with bankers on debt rescheduling. 25X1

Food Shortages in Zaire Mining Region

Kinshasa is having difficulty supplying the mineral-rich Shaba Region with corn—the dietary staple. Drought has sharply reduced deliveries from Zimbabwe and South Africa, and the government corporation responsible for supplying Zaire's mining industry has drastically reduced distribution of cornmeal to mineworkers. Deliveries to other recipients—including the Army, local schools, and hospitals—have been postponed until February. Many civilians and military personnel are forced to buy cornmeal smuggled in from Zambia; a 50-pound sack—barely enough to feed an average family for a month—reportedly is selling at twice a month's salary. With antigovernment sentiment already widespread in Shaba, food shortages could spark urban unrest. Moreover, Kinshasa is concerned that mineworkers might sabotage critical copper mining facilities; last October sabotage threats were made to protest a government wage freeze. 25X1 25X1

Thailand Overhauls State Enterprise Sector

The Thai Cabinet has approved in principle the sale of six unprofitable state enterprises—the Express Transportation Organization, the Thai Maritime Navigation Company, and four small manufacturing companies including sugar and paper mills—to the private sector. In addition, Bangkok tightened controls over expenditures and foreign borrowing of the approximately 60 remaining government-run firms. The state enterprise sector's foreign debt has grown rapidly and accounts for about 60 percent of the government's $9 billion foreign debt. Although the Prem administration has been more successful than 25X1

past governments in scaling back the state enterprise sector, the latest moves are likely to meet resistance. Selling the Express Transportation Organization, which has almost 5,000 employees, is opposed by the strong public-sector labor unions. The Labor Congress of Thailand has threatened a general strike if the sales take place. 25X1

Communist

Status of CEMA Economic Summit

Preparations for an economic summit of CEMA members have been completed, and only the continued absence of General Secretary Andropov is holding up scheduling of the meeting. Press sources state that the Soviets hinted last month that the meeting might be held at the end of February, but sources at East European embassies in Moscow now expect a delay of several more months. The Yugoslav press, citing sources at the CEMA Secretariat, reports that the Soviets and East Europeans have agreed in principle on the summit agenda after more than a year of discussions. The most important decision is to 25X1 tie deliveries of Soviet energy and raw materials more closely to East European investment in Soviet resource development projects. Members also have agreed to grant state enterprises new freedom to deal directly with similar enterprises in other member countries. The meeting probably will do no more than ratify these decisions. Moscow originally proposed sweeping changes that would have markedly increased economic integration in CEMA, but opposition by the East Europeans apparently forced the Soviets to abandon these proposals. 25X1

Yugoslav-Soviet Trade Agreement

Yugoslavia and the USSR last week signed a trade protocol for 1984 that calls for total trade of $6 billion worth of goods and services. 25X1

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Last year, according to preliminary figures, the Soviet Union delivered an additional 20,000 b/d above the 90,000 b/d of crude called for in the 1983 agreement. Since the onset of Yugoslavia's financial crisis in 1982, the USSR has been generally supportive by increasing the level of its energy exports. 25X1 Purchased through a bilateral clearing account, the Soviet oil has enabled Belgrade to partially offset the decline in oil imports from other countries that has resulted from foreign exchange shortages. 25X1

More Hungarian Price Hikes

Budapest this week ordered another round of consumer price increases. Retail prices of meat, poultry, fish, canned vegetables and fruit, and beer are up as much as 21 percent. Private automobiles—which Hungary imports almost totally from CEMA partners—will cost 6 to 7 percent more, and prices of home building materials are 20 to 30 percent higher. Large increases also were announced for household heating oil and utilities including electricity, water, and sewage. 25X1

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Government spokesmen have defended the actions as essential for Hungary to reduce subsidy spending, restrain consumer demand, and improve the foreign trade balance. Reductions in consumer and producer subsidies are central to Hungary's new stabilization program approved by the IMF in early January. As is customary with consumer price increases, some attempt to cushion the impact was provided through a small monthly income supplement to the poorest retired people and other hard-pressed families. Embassy officials reported little panic buying in advance of the expected announcement and a mood of grudging acceptance by the public, who are becoming resigned to annual price hikes as the government struggles to stabilize the economy. [redacted] 25X1

Cubans and Dutch Explore Trade Possibilities

[redacted]

An official Dutch delegation held trade promotion talks with Cuba last month. The discussions in Havana considered cooperation in the sugar industry and a commission was formed that will coordinate efforts between agriculture ministries. [redacted] 25X1

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[redacted] Representatives from 30 Dutch companies and the agriculture ministry will return to Cuba in March to examine new trade opportunities. The Dutch probably will urge the Cubans to use the Rotterdam fruit terminal to be completed in 1985 and they hope to become involved in Havana's extensive port improvement plans. Bilateral trade between the two countries has grown rapidly in recent years although it comprises only a small percentage of either country's worldwide trade. [redacted] 2:25X1 25X1

Soviets Purchase Japanese Pipe

[redacted] 25X1

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[redacted] The USSR's import requirements are lower because planned construction of long-distance pipelines is tapering off and because the Soviets are able to manufacture more pipe. [redacted] 25X1

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Ireland and the USSR Resume Normal Trade Relations

Irish-Soviet trade relations have returned to normal less than three months after the Korean Airlines (KAL) incident and the supposedly unrelated expulsion of two Soviet diplomats from Ireland in September. In mid-November the Soviets held their first solo trade fair in Dublin, which was timed to mark 10 years of diplomatic relations with Ireland. By early

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December, the annual bilateral trade talks—which had been "indefinitely postponed" by the Irish Government following the KAL shootdown—were completed, with both parties stating their determination to increase trade. [redacted] 25X1

Ireland, which has been hard hit by the world recession, achieved a surplus in its trade with the Soviet Union last year. Although Dublin joined other West European countries in condemning the Soviet attack on the KAL aircraft, it was careful not to impose sanctions that would hurt the Irish economy or cause longstanding friction with Moscow. Dublin claimed that its neutrality in East-West relations proscribed placing any major restrictions on Aeroflot's use of Shannon Airport—the airport receives 43 percent of its revenues from this traffic. For their part, the Soviets did not respond in kind to Irish statements or actions and have attempted to restore cordial relations between the countries as soon as possible. [redacted] 25X1

Vietnam Cuts Back Rice Exports to the West

[redacted]

Vietnam appears to be cutting back rice exports to the West in an effort to increase deliveries to the USSR and Eastern Europe. Last month, Hanoi announced that it would reduce planned exports of rice to a French trading company from 300,000 metric tons to 120,000 tons for 1984. Under the original agreement, Hanoi was to provide rice and coal to the French firm in exchange for fertilizer and wheat over a period of four years. At the same time, Vietnam is increasing rice exports to COMECON countries. We believe the 25X1 shift results from Soviet pressure on Hanoi to repay its approximately $4 billion economic debt to Communist countries. [redacted] 25X1

International Financial Situation: Political Update [redacted]

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This article is part of our series focusing on the economic and political aspects of the international financial situation. [redacted]

Political trouble caused by reaction to economic austerity measures is spreading—from the large debtor nations to the smaller financially troubled countries around the world. Strikes and violence have flared up over the past month in countries as disparate as Suriname, Sierra Leone, Tunisia, and Israel. Nowhere was the politics of economics brought home with greater vengeance than in Nigeria, where the recently reelected civilian government was overthrown by the Army. [redacted]

In Africa:

- President Stevens of *Sierra Leone* has closed the main university indefinitely, following violent student disturbances earlier this month in the capital over shortages of cooking oil and gasoline. If Stevens imposes austerity measures needed to obtain IMF assistance, public disaffection over layoffs, inflation, and shortages of essential goods is likely to increase.

- In *Senegal,* students, labor, and Muslim leaders are becoming more dissatisfied about the country's economic decline, and the Embassy believes President Diouf increasingly will be blamed for the effects of austerity measures he imposed in August. Senegal's military has remained aloof from politics, but divisive political wrangling in the face of economic hardship is likely to provoke grumbling in the officer corps and perhaps lead to coup plotting.

- In the *Ivory Coast,* the second-largest debtor nation in Sub-Saharan Africa after Nigeria, the Embassy reports that top officials are concerned that economic troubles, which have prompted austerity measures, could provoke social unrest. 25X1 [redacted]

In the Middle East:

- The US Embassy in *Morocco* reports that isolated incidents of violence have occurred in several cities this month but that there has been no general strike over deteriorating economic conditions. [redacted] Rabat may have to choose between carrying out austerity measures required by the IMF to ensure more financing and risking serious disturbances similar to the food-price riots that occurred in 1981.

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- In *Israel,* threats by the smaller parties to leave the coalition and growing labor unrest—15 percent of public-sector employees are involved in strikes or slowdowns—have severely tested Prime Minister Shamir's ability to hold his coalition together and to enact needed austerity measures. Shamir was able to obtain Cabinet agreement on an austerity budget, but we doubt the cuts will be implemented. [redacted] 25X1

In Latin America:

- The strike by *Surinamese* bauxite workers lasted five weeks despite the resignation of Prime Minister Alibux and his Cabinet and despite the decision of Army Commander Bouterse to suspend controversial increases in income taxes, commodity prices, and import duties. The strike closed down the aluminum industry, which accounts for 80 percent of Suriname's exports and at least 20 percent of government revenues. Even though the

labor dispute was settled this week, the new Cabinet faces severe economic problems requiring harsh austerity measures that could lead to more unrest.

- In *Uruguay,* the government has dissolved the six-month-old labor confederation that organized a nationwide strike last week, has banned news reports about the work stoppage, and has prohibited party or labor union meetings. The strike came as workers demanded pay increases to offset rapid inflation and the military government was rumored to be considering postponing elections it had earlier proposed be held in November. The effectiveness of the strike, which follows a massive antigovernment rally last November, is likely to cause more concern in the military about the wisdom of civilian rule. [redacted]

The political backlash is having a noticeable impact on economic policy decisions. Austerity measures have recently been rescinded or softened, for example, in Tunisia and Poland. Whether these moves will bring more than a temporary calm remains to be seen. In other countries, such as Nigeria and the Philippines, governments are strongly resisting even initiating policies they must implement to obtain IMF and bank rescue packages for fear of unrest:

- President Bourguiba of *Tunisia* abruptly rescinded bread price increases after widespread riots broke out in late December. We believe the protests reflect discontent with a political establishment that many of the urban poor, the young, and the unemployed find insensitive to their needs. Radical Muslims are particularly well placed to exploit the strains. The price rollback ended the disorders but will require the government to postpone several development projects planned for this year and increase prices of some other subsidized goods. A new budget probably will hurt the middle class, the government's traditional base of support, and it could endanger wage agreements between the government and organized labor.

- An IMF team is in *Tanzania* trying to break the yearlong deadlock on a new loan package. President Nyerere reportedly continues to refuse the IMF's demand for a large devaluation because he believes such a move, which would result in price increases and commodity shortages, would stir up civil unrest.

- General Buhari's month-old regime in *Nigeria* finally appointed a cabinet last week, but it has put off resuming negotiations with the IMF until the new economic team has had time to review the former government's budget. [redacted] 25X1

[redacted] 25X1

[redacted] Coup leaders still appear to be groping for policies and are likely to find that expectations raised following the coup will make it even harder to win popular support for an austerity budget. [redacted] 25X1

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International Financial Situation: Devaluations Assist Trade Improvement

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This article is part of our series focusing on the economic and political aspects of the international financial situation.

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Most financially troubled LDCs have devalued their exchange rates to improve their trade position. To establish competitiveness, however, requires devaluations sufficient to offset inflation differentials between the devaluing country and its trading partners. For a select group of 15 LDC debtors, our analysis of real—price adjusted and trade weighted—exchange rates shows that most of these countries experienced real devaluations last year. Brazil, Chile, and Indonesia recorded real devaluations of 20 percent or more.[1]

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[1] The 15 countries we examined are Argentina, Brazil, Chile, Costa Rica, Ecuador, Indonesia, Ivory Coast, Kenya, Mexico, Morocco, Nigeria, Peru, the Philippines, Venezuela, and Zaire. We calculated the purchasing-power parity exchange rates by taking the ratio of the consumer price index of each country to a trade-weighted average of the consumer price indexes of the country's 10 main Western trading partners, with all indexes converted into dollars at prevailing exchange rates. The base year for our comparisons was 1975, which is prior to the second runup in oil prices and the sharp rise in commodity prices, which occurred in the late 1970s. The calculated real exchange rates do not represent absolute levels of overvaluation or undervaluation. Instead, they provide a way to calculate change and take any 1975 exchange rate distortions as a given.

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Selected LDC Debtors: Real Exchange Rates [a]

Index: 1975=100

	1975	1980	1981	1982	1983	1982				1983			
						I	II	III	IV	I	II	III	IV
Argentina	100	241	226	112	101	154	137	70	91	93	95	108	106
Brazil	100	74	87	89	69	87	90	92	87	77	66	67	65
Chile	100	114	136	121	94	141	137	109	96	90	95	96	96
Costa Rica	100	93	52	51	61	43	48	55	58	61	63	61	60
Ecuador	100	114	121	115	111	128	115	102	114	119	104	110	112
Indonesia	100	80	85	93	74	91	92	95	94	91	67	69	69
Ivory Coast	100	131	121	111	104	117	116	107	105	107	105	102	100
Kenya	100	102	99	102	96	98	101	104	103	94	95	96	100
Mexico	100	91	102	73	62	90	72	64	67	60	62	63	64
Morocco	100	98	91	90	81	92	89	90	89	87	85	80	74
Nigeria	100	147	161	159	176	158	157	161	161	164	170	179	191
Peru	100	66	77	77	69	80	79	77	74	71	68	66	70
Philippines	100	100	101	107	88	106	106	110	105	97	92	90	72
Venezuela	100	106	118	128	132	124	127	124	130	129	131	133	135
Zaire	100	145	139	145	156	129	135	150	166	187	205	176	55

[a] Price adjusted and trade weighted.

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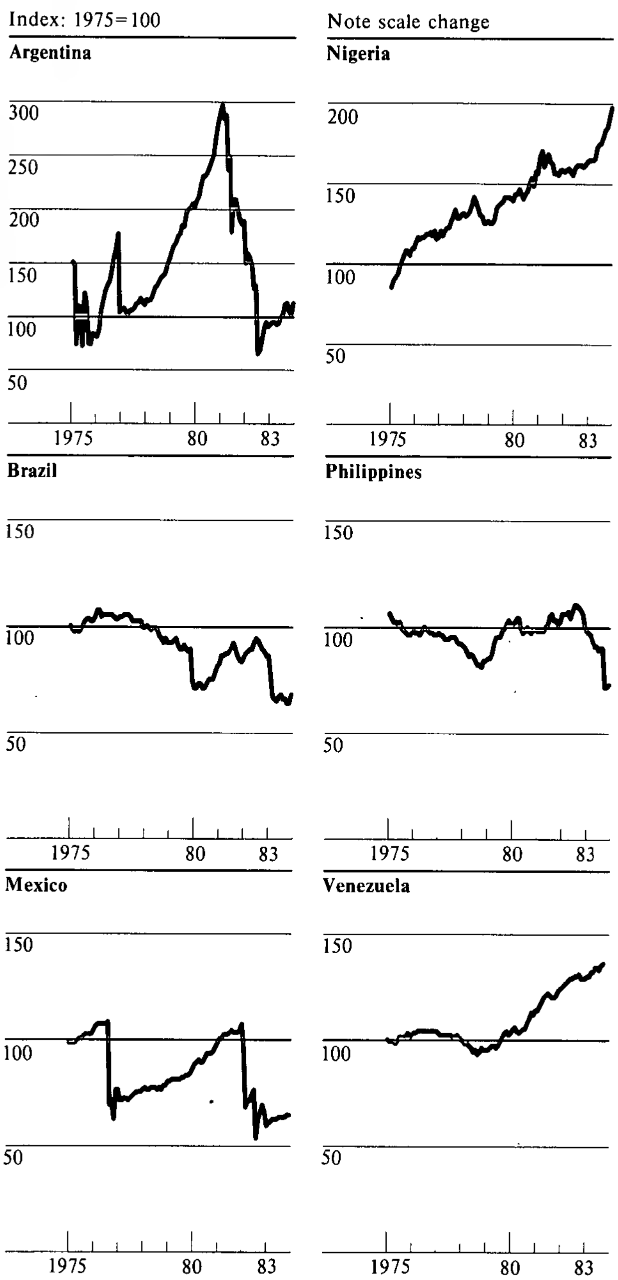
Selected LDC Debtors: Real Exchange Rate Index, 1975-83[a]



[a] Price adjusted and trade weighted.

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Real Exchange Rate Drop

LDC debtors were forced to devalue their currencies in response to their financial difficulties. Currency devaluations usually were part of comprehensive economic adjustment programs negotiated with the IMF. By lowering the foreign price of their exports and raising the domestic price of their imports, devaluations are intended to improve a country's trade position and its ability to service foreign debt. 25X1

We estimate that, on average, the 15 LDC debtors devalued their currencies about 8 percent in real terms in 1983 over 1982. Eleven of the countries we examined had lower real exchange rates in 1983 than in 1982. The four exceptions were Costa Rica, Nigeria, Venezuela, and Zaire. Zaire, however, moved to correct its overvalued currency late in 1983 with a major devaluation, and by December the real effective exchange rate stood about 70 percent below the level of a year earlier. 25X1

The largest real devaluations were recorded by Brazil, Chile, and Indonesia, with declines of more than 20 percent in 1983. Argentina, Mexico, Morocco, Peru, and the Philippines experienced real exchange rate declines of 10 to 20 percent. In the cases of Argentina and Mexico, these exchange rate corrections followed real declines in 1982 of 50 and 30 percent, respectively. 25X1

All but three of the 15 countries—Ivory Coast, Kenya, and Venezuela—have exchange rate policies involving some sort of managed float. Most have been gradually depreciating their currencies with monthly or even daily adjustments. In addition, most of the 15 debtors, like Brazil and Mexico, instituted "maxi-devaluations" during 1982 or 1983 in a one-time attempt to correct their overvalued currencies. 25X1

Outlook

We believe Nigeria, Venezuela, and the Philippines are prime candidates for major devaluations in the near term. Nigeria's new military government is 25X1

currently under pressure from its creditors and the IMF to devalue the naira. Our calculations indicate that a major devaluation probably is long overdue—the naira has appreciated 90 percent in real terms since 1975. Venezuela's new government is under external and internal pressure to unify its multiple exchange rates at a devalued level. Even the head of the Venezuelan central bank has called for a devaluation of the bolivar. Although President Marcos has declared that the Philippine peso will not be devalued again, he is under considerable pressure to adopt a more flexible exchange rate policy. Our calculations indicate the peso is already at its lowest level since the mid-1970s, but IMF pressure and the sharp divergence between the official and black-market exchange rates may make further devaluations necessary. 25X1

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Airbus Industrie: Prospects for the A320 Enhance Long-Term Goals [redacted] 25X1

Western Europe's Airbus Industrie appears near a formal commitment to build the A320, an all-new, 150-seat, advanced-technology aircraft. Several West European aerospace officials say that the consortium "internally launched" the narrow-body design last fall and that engineering work since then has picked up. These actions, coupled with the West European perception of an improved competitive climate and some increase in agreement among consortium countries, have led Airbus officials recently to reaffirm a projected delivery date of 1988. Although sales for all large commercial aircraft remain weak and Airbus has an inventory of 20 unsold wide-body models, the consortium believes a timely move to narrow bodies is necessary to maintain the West European commercial aerospace industry and work force and to provide the consortium with a "family of aircraft" to compete more effectively with US manufacturers. [redacted] 25X1

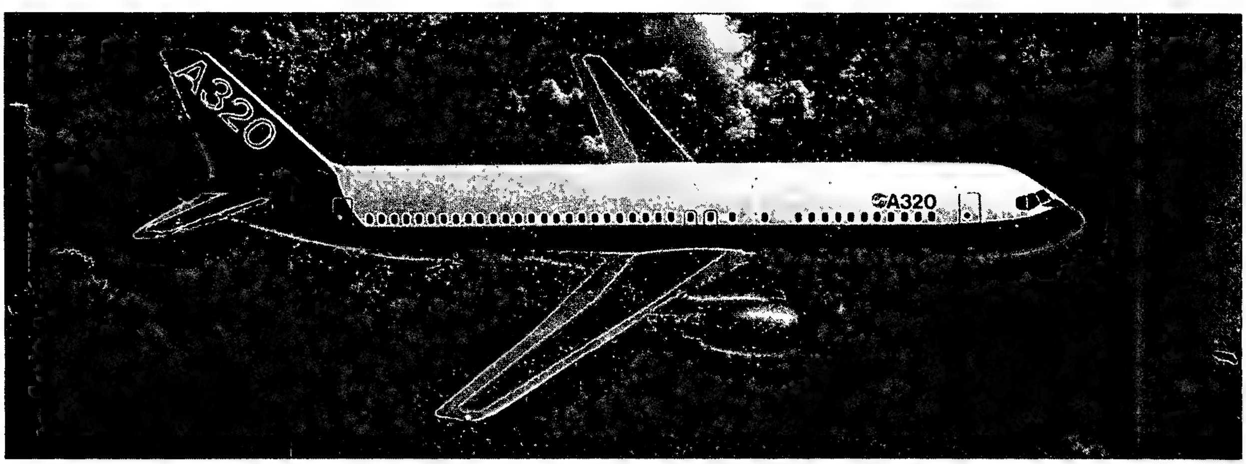
The 150-Seat Market

Commercial aircraft manufacturers in Western Europe, the United States, and Japan have been reviewing 150-seat designs for several years. Although the recession and a slowdown in the growth of air traffic has made manufacturers cautious, most aviation experts believe the future 150-seat market is huge. Sales during 1986-2000 could reach 2,300 narrow-bodied aircraft, worth $70 billion. Airbus officials believe the core of demand is for an all-new aircraft rather than derivatives of existing models. If the final A320 go-ahead occurs in the next few months, it is scheduled to be available in mid-1988—at least a year earlier than any all-new US design. In an effort to boost its competitive edge, Airbus has been fine tuning the design to lighten the aircraft and improve efficiency. [redacted] 25X1

A320: The Current Scene

A number of recent developments suggest that the A320 program will formally begin in early 1984:

- *New orders*: A British Caledonian Airlines (BCAL) order and the signing of a letter of intent



A320 [redacted] 25X1

by the Yugoslav charter carrier Inex-Adria totaled 18 aircraft (including orders and options) valued at some $450 million.

- *Improved consortium climate*: A provision in the 1984 West German budget that could provide $445 million for the A320 and growing British industry and labor pressure for the UK Government to back the program.

- *Stronger competitive position*: The European perception that McDonnell Douglas has withdrawn a proposal for an all-new 150-seat D3300 design.

Growing Order Book

Orders and options for the A320 stand at 88 aircraft in mid-January, close to the 100 units desired by many government and Airbus officials for a formal launch of the design. Air France placed the initial order for 25 aircraft with an option for another 25. Air Inter, France's domestic carrier, followed in mid-1983 with 10 firm orders and 10 options. BCAL's commitment in October 1983 for 10 aircraft—seven firm orders and three options—gave the consortium a significant boost because it is a privately owned airline. Although the contract has a cancellation clause if the A320 cannot be delivered by the spring of 1988, Airbus has assured BCAL equipment managers that the aircraft delivery schedule will be met. In December, Yugoslavia's Inex-Adria signed a letter of intent for eight aircraft—five firm orders and three options. In addition, Airbus has held extensive talks with Swissair. Elsewhere, the French are pressing Indonesia's Garuda Airlines and have offered such incentives as a soft loan not tied to the A320 purchase and possible offset production and technology transfer to Indonesia's Nurtanio Aircraft Company.

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Improved Consortium Climate

There is increasing momentum favoring the A320 in West Germany and the United Kingdom. The four risk-sharing companies of the consortium have reached agreement in principal that would result in the following division of work: 34 percent to France; 26 percent to the United Kingdom; 37 percent to West Germany; and 3 percent to Spain. With continued strong backing by the French, support by West Germany and the United Kingdom remains the key. An increasing number of government, industry, and airline officials in West Germany favor an A320 go-ahead, and Bonn has moved in recent weeks to commit itself to the design. The West German Government approved a $4.5 million progress payment to the A320 project last November and, in early December, parliament approved $445 million of conditional funds in the budget. The government spending proposal will be reviewed before formally obligating funds, probably by spring 1984. 25X1

The West German actions indicate that Franz Josef Strauss, chairman of Deutsche Airbus and Minister-President of Bavaria, has successfully pressured the government to back the A320. Although Strauss would like Lufthansa to be a launch customer, the airline has so far refused. 25X1

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The Government of the United Kingdom is under heavy pressure from the aerospace industry and labor to approve funding requested by British Aerospace for the A320 program. The government has promised a decision early in 1984. Analysis of

the program, however, is expected to be especially thorough because the funding could reach $650 million. As of early 1984, the consensus of aerospace analysts is that the United Kingdom will back the A320 because of: the West German trend toward approval; concern about the British aerospace industry and its work force; and positive recommendations on the A320 by industry officials.

The recent antitrust clearance given to an international consortium by the US Justice Department to build a new engine, designated the V2500, puts additional pressure on the United Kingdom to support the A320 and may help Airbus Industrie market the new aircraft. Britain is anxious that the engine project go forward. The consortium, led by Rolls-Royce and Pratt and Whitney, announced it would proceed with the $1.5 billion development of a high-technology aircraft engine designed for a 150-seat airliner. If available as planned in 1988, the new engine could counter the objections of some airlines, including Lufthansa, that the A320 have a more advanced engine rather than a CFM-56 derivative.

Outside the existing Airbus consortium, Italy and Canada are the two most important countries still evaluating the possibility of participating in the A320 program. France is negotiating with Italy for participation in the A320 program as a result of the McDonnell Douglas withdrawal from several new programs. Italy has been involved in McDonnell Douglas programs in the past, and, unless US industry comes up with an attractive alternative offer, the Italian industry's need for work may move them toward participation in Airbus programs. The French, however, are insisting that Italy's Alitalia buy the A320 as a condition for participation, and we believe Italy is unlikely to make a quick decision.

The Canadians are still evaluating A320 proposals but are undecided because of the financial troubles of their aerospace industry. Moreover, a recent agreement to build a Bell helicopter production facility carries a large start-up cost. Canadair, Canada's largest aerospace firm, as well as DeHaviland, had huge losses in 1982. Nevertheless, Canadian officials recognize the cost advantages of being an early customer, and if Airbus Industrie offered a favorable A320 manufacturing program it could tip the scales. We believe, however, that problems in Canada's aircraft industry will keep Ottawa from participating. 25X1

The Competitive Scene

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Airbus believes the current competitive environment is favorable to their plans and timing with the A320. The consortium believes that, as a new technology design, the A320 will sell well against US manufacturers now offering only derivatives of existing aircraft—the MD-80 from McDonnell Douglas and the Boeing 737-300/400 aircraft. Moreover, Airbus believes the recent McDonnell Douglas decision to cancel concept work on several new designs makes it unlikely the US firm will build the D3300. Although Boeing is likely to have their own all-new design, the 7-7, most analysts believe it could not be ready until mid-1989. Over the longer term, most European aerospace officials say that only Boeing is likely to compete with 25X1 Airbus across the board. The Europeans perceive this possibility as strengthening arguments in the UK and West German Governments that Europe must have a manufacturer of a family of commercial aircraft, not only wide bodies, to prevent a Boeing monopoly. 25X1

Implications for the United States

An Airbus Industrie move into the narrow-body sector of the commercial aircraft market with the A320 will erode US sales, set the stage for further expansion of the consortium's product line, and make profitability of any all-new US program harder to attain. Even before the pullback of 25X1 McDonnell Douglas from an all-new 150-seat design, Airbus officials set a goal of attaining at least a 30-percent share of the 150-seat market. We now believe Airbus is setting its goal closer to 40 percent with a special emphasis on selling the new design to one or more US airlines. Airbus may consider

offering some form of coproduction arrangement of the A320 to US firms in an effort to secure US sales. 25X1

Over the longer term, building the A320 could accelerate Airbus plans to expand its product line and become competitive across the board with US manufacturers. The A320 itself is likely to evolve into a series of derivatives with various capacities and ranges. A wider selection of aircraft will enhance Airbus's image with airlines around the world. If in turn Airbus revenues increase, this could spur faster introduction of additional wide-body designs such as the TA-11, a four-engine 225-passenger aircraft for transoceanic operation. Lufthansa has long sought such an aircraft. Other possible designs include the TA-9, a stretched version of the A310, and the TA-12, a long-range twin-engine aircraft. 25X1

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Tunisia: In the Aftermath of the Bread Riots [redacted]

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Resentment in Tunisia over continuing regional disparities in income and rising unemployment and prices came to a head at the end of December when steep bread price increases triggered nationwide riots. The disturbances were quieted only after the military was called out and President Bourguiba reinstituted grain subsidies. The government now must seek alternative ways to cut its budget deficit and must struggle to restore its damaged prestige and credibility. The bread riots reflect deep social strains in Tunisia and unhappiness with a political establishment judged by many of the urban poor, the young, and the unemployed as insensitive to their needs. The disorders have weakened Prime Minister Mzali's chances of succeeding President Bourguiba and will make it extremely difficult for the government to enact needed austerity measures. [redacted]

Tunisia: Current Account Balance *Million US $*

	1981	1982	1983 [a]
Trade balance	−1,025	−1,159	−1,195
Exports (f.o.b.)	2,072	1,954	1,660
Petroleum	1,331	835	702
Imports (f.o.b.)	3,097	3,113	2,855
Services and transfers (net)	582	584	560
Tourism	597	567	546
Worker remittances	358	371	385
Current account balance	**−443**	**−575**	**−635**

[a] Estimated.

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[redacted]

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Events Leading Up to the Riots

The last few years have been disappointing for the Tunisian economy. Tunisia's main foreign exchange earners—oil, tourism, phosphates, and worker remittances—stagnated under the weight of the worldwide recession. After a lackluster economic performance in 1982 and faced with reduced government revenues, Tunisia instituted an economic austerity program in 1983. Its efforts were frustrated, however, by another poor agricultural harvest, a $4.00 drop in Tunisia's oil prices, and French currency restrictions that limited tourism. [redacted]

OPEC's decision in March 1983 to lower oil prices sent Tunisian officials scrambling to cut back spending. Officials estimated that government revenues from oil exports would fall by 11 percent. The current account deficit was forecast to increase by $60 million as a result of the oil price change.

With a record $430 million trade deficit for the first quarter, the government decided to slash import quotas. Officials considered canceling all outstanding orders for US military equipment, but this was dropped when the United States delayed some payment dates and increased the level of FMS credits. [redacted] 25X1

In 1983 the government won a labor agreement to limit wage increases across the board to 10 percent compared to 20 to 30 percent in the preceding two years. In turn, the government promised to hold down prices and then delayed subsidy reductions so that the labor agreement would stick. [redacted] 25X1

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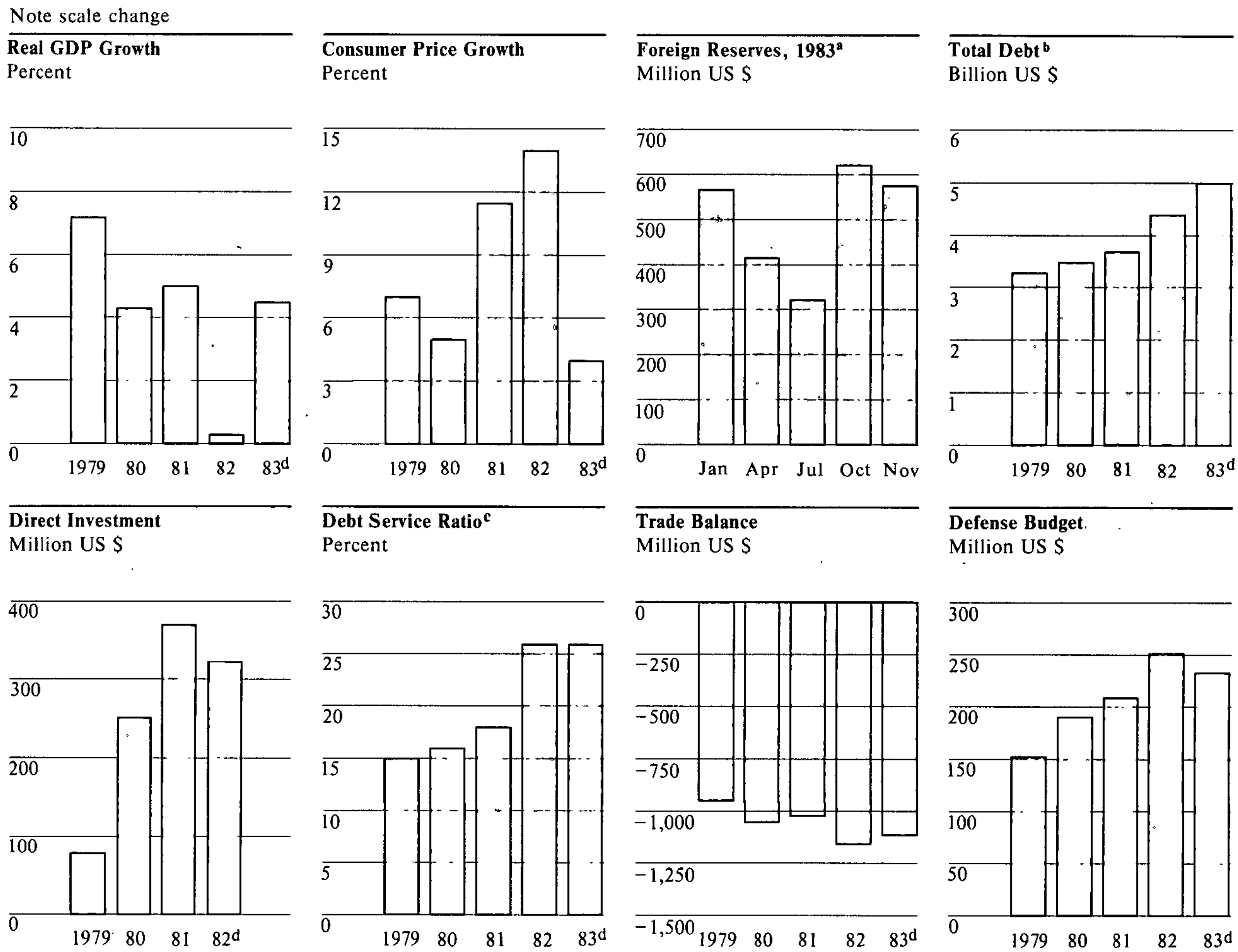
By late 1983 the economy was gradually pulling out of its slump. Nonetheless, the unemployed and the poor were hard hit by cuts in public spending and delays in major projects in less developed regions. [redacted] 25X1

Tunisia: Economic Indicators, 1979-83



[a] Excluding gold.
[b] Including public and private, guaranteed and nonguaranteed debt.
[c] Ratio debt service payments to exports of goods and services.
[d] Estimated.

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The Quick Fix—A Miscalculation

Contemplated reductions in cereal subsidies were repeatedly postponed throughout the year as various Cabinet ministers debated with Prime Minister Mzali over which subsidies to reduce, by how much, and when. Several ministers were "relieved of their assignments" as a result of policy disputes.

While inflation declined from 14 percent in 1982 to less than 5 percent for 1983, government subsidies mounted. 25X1

Last fall, during 1984 budget deliberations, attention turned to the cereal subsidy, which was forecast to grow by 30 percent in 1984. Possibly as a

result of the low level of visible public dissent over the austerity measures applied in 1983, but also because of direct pressure applied by Bourguiba, the Cabinet decided to eliminate completely the cereal subsidies in 1984. Previously, the politically sensitive subsidies affecting bread and other wheat products had been left untouched even as other subsidies were reduced. The Tunisian Government realized this would be a politically dangerous step—one which had caused riots in Egypt in 1977 and Morocco in 1981—but was confident that government preparation and countermeasures to protect the poorest groups could preclude popular outbursts.

Tunis tried to ensure the support of labor by holding negotiations with the General Union of Tunisian Workers (UGTT) during December to work out acceptable wage increases that would partially compensate labor for the price increases. Two opposition parties were legalized at the end of November, possibly to deter them from criticizing the government over the subsidy cuts. Finally, during the last week of December, Mzali announced supplementary welfare subsidies to help offset the price increases for the poor, but this was ineptly handled—the increases were not in place before the new prices took effect.

Although the UGTT claimed afterward that it had tried to warn the government of the possible repercussions, government, party, and labor officials appear to have failed completely to anticipate the intensity of the public reaction to the price hikes. This failure has confirmed popular perceptions that "official" Tunisia is out of touch and insensitive to the plight of the poor.

Riots

On 29 December, even before the price increases took effect, violence erupted in the southern and central regions and quickly spread over the rest of the country. On 3 January, with the police unable to restore order, Bourguiba declared a state of emergency and called in the Army to quell the disturbances. Three days later, Bourguiba rescinded the price increases and called for a new budget within three months to better address the needs of the poor. 25X1

The protests have badly damaged the political image of Mzali, who was charged with carrying out the decision to remove the subsidies. His statements during the disturbances that the government would proceed with its program probably reaffirmed popular misconceptions that he—rather than Bourguiba—had planned the price hikes. Bourguiba's abrupt suspension of the price increases undercut Mzali's own efforts to make amends with the poor. Moreover, the Prime Minister is blamed for ordering the sometimes heavyhanded suppression of the riots by Army and security forces. 25X1 25X1

Economic Costs

The riots caused extensive physical damage. Post offices and other government buildings, public transportation, and even Bourguiba's summer palace were damaged. Furthermore, the US Embassy has received reports of attacks on mining facilities and factories. Because violence was directed against the Tunisian middle and upper class and symbols of government authority, government and commercial properties were hit hardest. The tourist industry, a mainstay of the economy, is likely to be damaged by hesitancy on the part of prospective Western visitors in the wake of the riots. The confidence of foreign investors—many of who are from the Gulf states—almost certainly has been shaken. 25X1 25X1

Bourguiba's decision to maintain the cereal price subsidies will be expensive—costing at least an additional $200 million this year. To limit spending, the new budget will have to reduce other, less politically sensitive subsidies and probably will postpone development projects. These measures will tend to slow economic growth, reduce new job openings, and boost prices of essential goods resulting in further demands for compensation from labor, youth, and the poor. 25X1 25X1

Prospects

Tunisia is counting on foreign investment and assistance—especially from the United States—and hoping for no further deterioration in the oil market. Although the Embassy reports that investor confidence in Tunisia has been shaken, Tunisia may still be able to secure considerable investment funds through five recently established joint Arab-Tunisian banks. Investor response until the riots had been encouraging. US private investment in oil exploration and development was active, and US cooperation in agricultural development and technology transfer was increasing. Barring further disturbances, we do not anticipate any significant fallout. [redacted] 25X1

Mzali's new budget almost certainly will have to include cutbacks that directly affect the middle class—his traditional political base—in order to shift funds to address the needs of the poor. Mzali also will have to maintain labor support. Nonetheless, having flexed their muscles so spectacularly, the poor and the young may again try to exert their influence unless they believe their needs are being met. [redacted] 25X1

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Afghanistan: Growing Economic Dependence on the Soviets [redacted]

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Unable to halt the slide in the economy since the Soviet invasion in December 1979, Kabul has turned to the Soviet Union for financial support to operate the government as well as for food and other supplies to alleviate shortages in government-controlled areas. The Soviets' growing economic involvement has enabled them to strengthen their hold on key sectors in those areas under Kabul's control. [redacted]

Afghanistan: Agricultural Production *Thousand metric tons*

	1976	1982 Government Statistics	1982 Western Estimates
Foodgrains	4,580	4,460	3,400
Wheat	2,940	2,860	2,200
Fruits and vegetables	1,640	1,830	NA
Industrial crops	380	200	NA
Cotton	160	55	NA
Sugar beets	90	30	NA

[redacted]

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Role of Agriculture

The main economic activities in Afghanistan are agriculture and animal husbandry. Production of foodgrains utilizes 90 percent of the land under cultivation, with wheat alone accounting for 60 percent. Agricultural output was growing by 3 percent annually in the mid-1970s, and the country was nearly self-sufficient in food production in 1976. [redacted]

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Agriculture—More Imports

Since the Soviet invasion, the agricultural sector has suffered greatly. [redacted] large numbers of landowners have fled the country, taking valuable machinery as well as financial assets. Total foodgrain production in 1982 was at least 1 million metric tons less than peak output of 1976, [redacted] In contrast, government figures show only a small decline in production. Kabul's data are highly suspect because the flight of roughly 4 million people to neighboring Pakistan and Iran and the migration to the cities almost certainly have reduced cultivated areas. [redacted]

Despite lower output and the disruptions caused by the insurgency—and contrary to reports by some Western journalists and Afghan refugees—food supplies probably were adequate for most of the population last year. [redacted] good crop conditions prevailed in most regions during the 1983 season and that harvesting generally was started on schedule. Most of rural Afghanistan, which is controlled by the insurgents or has only limited government control, appears to be almost self-sufficient in food. [redacted] food prices in the rural areas are down and no major shortages are occurring. [redacted] wheat from Herat Province is exported to

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Iran. We believe that, in areas where domestic supplies are insufficient, shortages are alleviated by imports from Pakistan. [redacted] about 140,000 tons of wheat are brought in annually by insurgents from refugee camps in Pakistan. [redacted]

In government-controlled areas, large-scale imports from the USSR have prevented serious food shortages. [redacted] the disruption of the transportation system, the government's inability to collect grain and other agricultural products in insurgent-controlled areas, and the reluctance of some farmers to sell to the government have left urban areas with serious shortfalls. According to Soviet and Afghan press reporting, wheat imports from the Soviet Union increased from about 75,000 tons in 1980 to 160,000 tons in 1983. [redacted]

Production of industrial crops, even by government records, has dropped dramatically. Harvests of cotton, the most important commercial crop, and sugar beets have declined by two-thirds since the mid-1970s. Processing industries, many of which depend on domestic agricultural supplies, have suffered. Cotton exports have declined, and the government has boosted sugar imports from the Soviet Union to make up for domestic production shortfalls. [redacted]

Energy—Total Dependence

The Soviet Union has nearly monopolized Afghanistan's commercial energy sector. Even before the Soviet invasion, Kabul was dependent on imports of petroleum products trucked overland from the Soviet Union. Subsequently, the Soviets have laid two small parallel oil pipelines from the Soviet border to Bagram airbase near Kabul. Although the pipelines are designed primarily to supply Soviet military forces, we believe that some supplies have been used for civilian purposes. [redacted]

Despite the Soviet commitment to supply fuel, Kabul has suffered periodic shortages of virtually all petroleum products since 1980. [redacted] these shortages have resulted from Soviet refusal to ship fuel until overdue accounts are paid and from delays caused by repeated insurgent attacks on fuel convoys and the pipeline from the Soviet Union. Kerosene currently is in short supply, while gasoline and diesel fuel supplies are adequate. Heavy fighting in the area between Kabul and the Soviet border is preventing tankers from reaching the city, and shortages will worsen unless the highway is reopened soon. [redacted]

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Disruptions in electricity supplies are making Afghanistan increasingly dependent on the Soviets for deliveries of fuel for electric power generation. According to US Embassy reporting, brownouts and supply interruptions in Kabul continue because of insurgent sabotage of transmission lines carrying hydroelectric power to Kabul. The city must now rely almost exclusively on overtaxed diesel-fired generators. According to US Embassy reporting, the situation is even worse in other cities such as Herat and Qandahar, where a lack of fuel has shut down government and private generators. [redacted]

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Improving electric power supplies will probably entail greater Soviet involvement in the only commercial energy sector where the government still has some control. According to official statements, the Soviets are planning an electric powerline from the Soviet Union through Kholm and Pol-e Khomri to Kabul intended for industrial enterprises. Other cross-border lines are being built to Towraghondi, in Badghis Province, and to Qonduz. [redacted]

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The Soviets dominate the natural gas industry—the country's most important natural resource and major export. Since 1957 the Soviets have provided credits, equipment, and technical assistance to develop this industry. The Soviets import about 95 percent of Afghan gas production; the remainder is used at a nitrogen fertilizer plant and a gas-fired electric power station. [redacted]

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We believe the Soviets had planned to increase gas imports substantially from a new gasfield at Jar Quduq. [redacted] Moscow had targeted total Afghan gas production at 4 billion cubic meters in 1981 and correspondingly increased the capacity of the 100-kilometer pipeline

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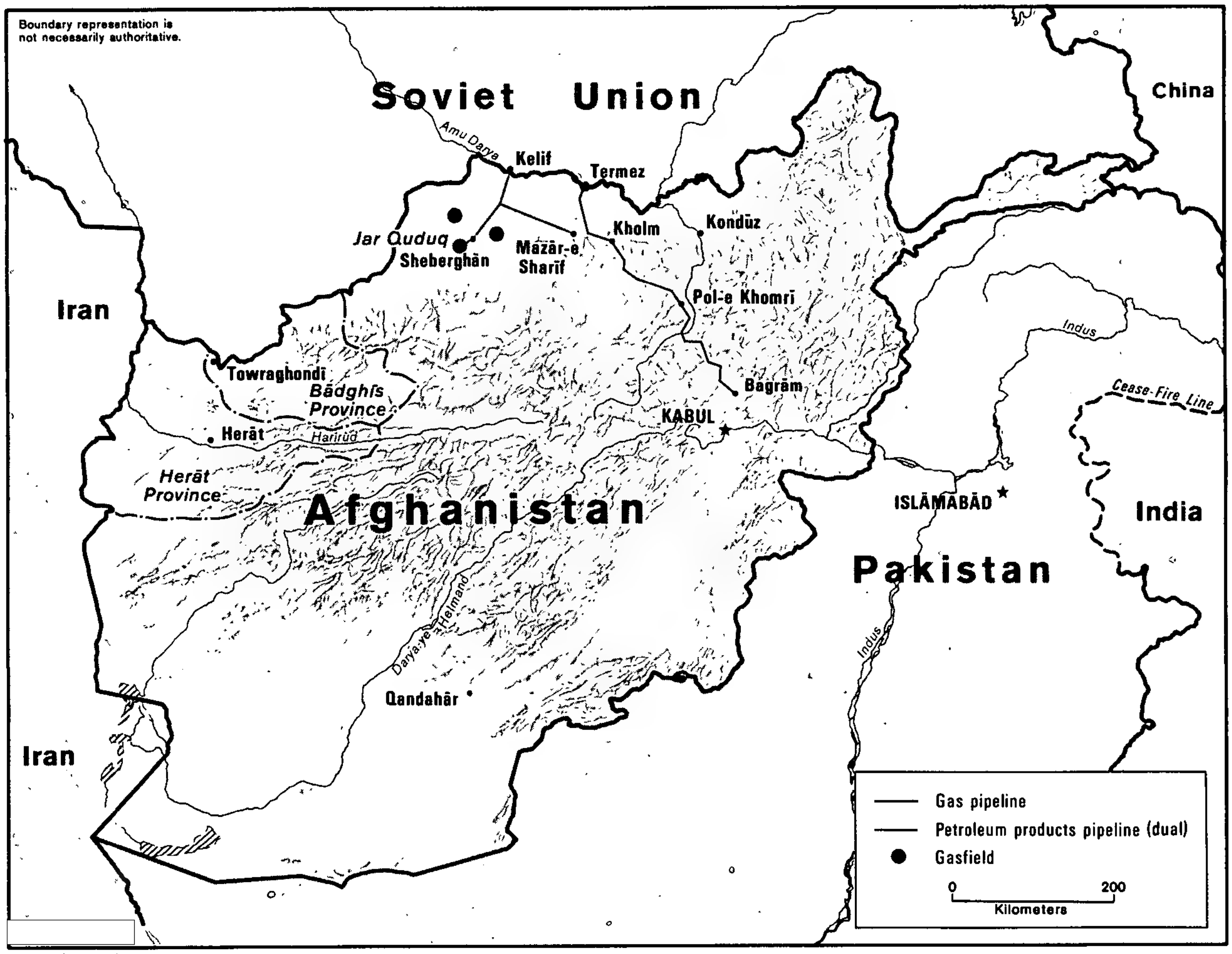

[redacted] 25X1

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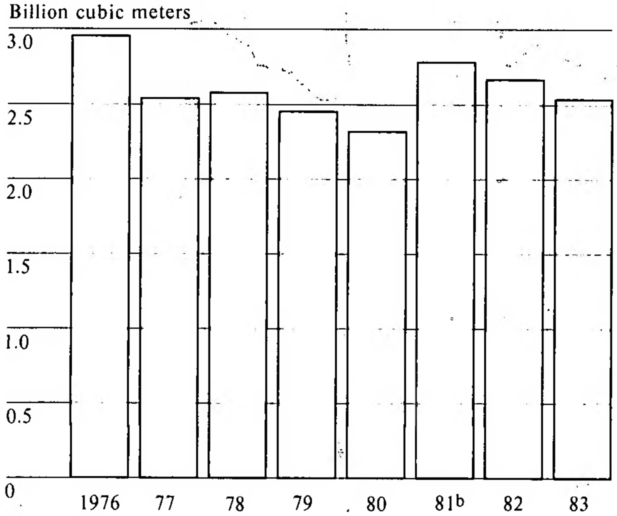
that carries the gas northeast from Sheberghan to the Soviet border. Although gas production increased significantly in 1981 when the new field came on stream, output has not approached the Soviet target. [redacted]

After 1981, gas output declined. [redacted] technical difficulties—probably shortages of operational equipment—and periodic insurgent interdiction of the pipeline have reduced production. We estimate gas exports to the Soviet Union last year were about 2.4 billion cubic meters compared with the 2.9 billion cubic meters delivered in 1975. According to a Kabul press report, the 1984 contract for exports to the USSR calls for no increase in volume. [redacted] 25X1

Trade—Changing Pattern 25X1

25X1 Trade with the Soviet Union has increased significantly since the Soviet invasion. Transportation difficulties have played a major role in the loss of Western markets for Afghan goods. Traditionally, most exports to the West transited Pakistan or were airlifted. The roads to Pakistan are frequently 25X1

Afghanistan: Natural Gas Production, 1976-83[a]



[a] By fiscal year which ends 20 March.
[b] New field on stream but output significantly less than original target of 4 billion cubic meters.

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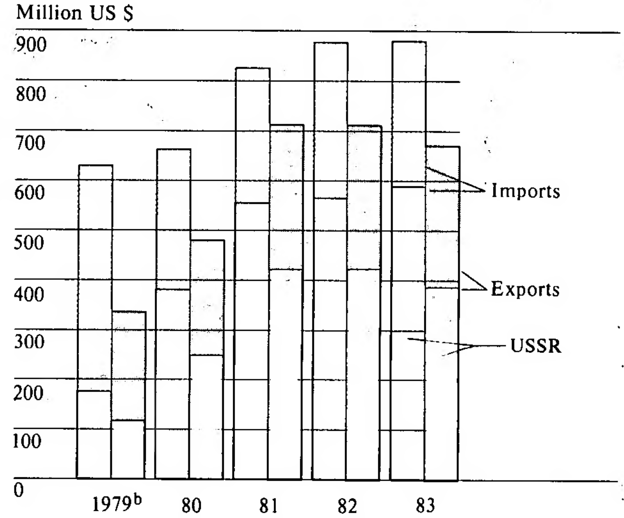
Afghanistan: Changing Trade Patterns, 1979-83[a]



[a] Trade is based on government statistics and does not include smuggling or trade in areas controlled by insurgents. The increase in exports between 1979 and 1983 is attributable in large part to a near tripling of prices paid for natural gas by the Soviet Union. 25X1
[b] By fiscal year which ends 20 March.

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blocked for days and are dangerous. The Afghan regime has suspended flights of the state-controlled airline to Western Europe. The Soviet Union was Afghanistan's major export market even before the invasion because it is the only feasible recipient of natural gas exports. Its share of total exports, however, has risen from 40 percent to almost 60 percent in recent years. The Soviet share of imports has doubled to about 65 percent in the past few years largely because of increases in food and capital goods imports.

Foreign Aid and Debt—Soviet Financial Support

During the 1970s, Afghanistan received substantial external financial assistance in the form of loans and grants from both Communist and non-Communist donors. Since the invasion, the Soviets have largely replaced other donors and have provided about $850 million in economic assistance as grants. We estimate all but about $100 million has been disbursed. Most of this funding has been used for essential imports. In addition, the Soviets have provided about $50 million annually in development assistance. Western aid has declined by more than one-half to less than $50 million annually. 25X1
Because of its Soviet ties, the Afghan Government has been denied access to $1 billion in development funds promised by OPEC states. 25X1

Soviet assistance has become critical to support the government budget. According to the Afghans, the Soviet occupation has led to a severe fall in government revenues. The decline in economic activity and the inability to collect taxes have made it difficult to finance the budget. Only with Soviet financial assistance and a tripling of the price the

Soviets pay for gas have the Afghans been able to come close to covering increased government expenditures. Exports of natural gas to the Soviet Union account for about 45 percent of government revenues compared to less than 25 percent before the invasion. [redacted]

Down the Road

We do not expect the Afghan economy to show any real improvement, because the insurgency ensures that:

- Transportation will be disrupted.
- The government will be unable to procure agricultural products and collect taxes from the countryside.
- Industry will face shortages of power, equipment, raw materials, and labor.
- The Soviets will gain greater influence in the economy as trade and aid from the West remain curtailed. [redacted]

Natural gas, in large part because of its proximity to the Soviet border, will remain the only viable industry for the Afghan Government. Nevertheless, the sale of natural gas will not provide Afghanistan with hard currency to buy goods from the West. The Soviets undoubtedly are committed to defending the gasfields from the insurgents because this is 25X1
the one sector of the economy that affords any significant economic benefit to them. [redacted] 25X1

There is little prospect that the Soviets will be able to reduce the amount of economic assistance provided to the Afghan Government in the near future. Although the Soviets currently are not saddled with large development projects, because there are none, they still must ensure that sufficient funds are available for food and fuel imports as well as the administration of the government. [redacted] 25X1

[redacted] 25X1

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